

## Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:PSI:B03-PLR-125001-02

Date:

September 3, 2002

### Legend

X =

D1 =

D2 =

D3 =

State1 =

State2 =

Dear :

This letter responds to a letter dated April 29, 2002, submitted on behalf of X, requesting a ruling under section 1362(f) of the Internal Revenue Code.

### Facts

X incorporated under the laws of State1 on D1. X elected to be treated as an S corporation on D2. Also on D2, X converted from a State1 corporation to a State1 limited partnership, electing to be treated as an association taxable as a corporation. X's conversion to a State1 limited partnership electing to be classified as an association for federal tax purposes may have created a second class of stock and inadvertently

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terminated X's S corporation election. X and its owners intended that X would continue to be treated as an S corporation. When X's shareholders became aware that X's conversion to a limited partnership may have inadvertently terminated X's S corporation election, X converted to a State2 corporation on D3.

X was unaware that the conversion to a State1 limited partnership might create a second class of stock and result in the termination of X's S corporation election. X represents that it did not intend to terminate its S corporation election.

### Law

Section 1361(a)(1) defines an S corporation as a small business corporation for which an election under § 1362(a) is in effect. Section 1361(b)(1) defines "small business corporation" as a domestic corporation that is not an ineligible corporation and that does not (A) have more than 75 shareholders, (B) have as a shareholder a person (other than an estate, other than a trust described in § 1361(c)(2), and other than an organization described in (c)(6)) who is not an individual, (C) have a nonresident alien as a shareholder, and (D) have more than one class of stock.

Section 1362(d)(2)(A) of the Code provides that an election to be treated as an S corporation terminates whenever (at any time on or after the first day of the first taxable year for which the corporation is an S corporation) the corporation ceases to be a small business corporation. The termination is effective on and after the date the S corporation ceases to meet the requirements of a small business corporation.

Section 1362(f) of the Code provides that if (1) an election to be treated as an S corporation was terminated under § 1362(d)(2) or (3), (2) the Secretary determines that the termination was inadvertent, (3) no later than a reasonable period of time after discovery of the event resulting in such termination, steps were taken so that the corporation is once more a small business corporation, and (4) the corporation, and each person who was a shareholder of the corporation at any time during the period specified pursuant to this subsection, agrees to make the adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to that period, then, notwithstanding the terminating event, the corporation shall be treated as continuing to be an S corporation during the period specified by the Secretary.

S. Rep. No. 640, 97th Cong., 2d Sess. 12-13 (1982), 1982-2 C.B. 718, 723-24, in discussing § 1362(f) of the Code, provides, in part, as follows:

If the Internal Revenue Service determines that a corporation's subchapter S election is inadvertently terminated, the Service can waive the effect of the terminating event for any period if the corporation timely corrects the event and if the corporation

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and the shareholders agree to be treated as if the election had been in effect for such period.

The committee intends that the Internal Revenue Service be reasonable in granting waivers, so that corporations whose subchapter S eligibility requirements have been inadvertently violated do not suffer the tax consequences of a termination if no tax avoidance would result from the continued subchapter S treatment. In granting a waiver, it is hoped that taxpayers and the government will work out agreements that protect the revenues without undue hardship to taxpayers . . . It is expected that the waiver may be made retroactive for all years, or retroactive for the period in which the corporation again became eligible for subchapter S treatment, depending on the facts.

Based on Rev. Proc. 99-51, 1999-52 I.R.B. 760 (December 27, 1999) Section 5.26 of Rev. Proc. 2000-3, 2000-1 I.R.B. (January 3, 2000), provides that the Service will not rule on the following issue because it is being studied:

Section 1361. -- Definition of a Small Business Corporation. -- Whether a state law limited partnership electing under § 301.7701-3 to be classified as an association taxable as a corporation has more than one class of stock for purposes of § 1361(b)(1)(D). The Service will treat any request for a ruling whether a state law limited partnership is eligible to elect S corporation status as a request for a ruling on whether the partnership complies with § 1361(b)(1)(D).

#### Conclusion

Based upon the information submitted and the representations made, we conclude that if X's conversion from a State1 corporation to a State1 limited partnership created a second class of stock resulting in a termination of X's S corporation election, the termination was inadvertent within the meaning of § 1362(f).

Pursuant to the provisions of § 1362(f), X will be treated as continuing to be an S corporation from D2 and thereafter, provided that X's subchapter S election is not otherwise terminated under § 1362(d).

Except as expressly provided herein, we express or imply no opinion concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

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This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

/s/

Christine E. Ellison  
Branch Chief  
Office of Associate Chief Counsel  
(Passthroughs and Special Industries)

Enclosures (2)

Copy for section 6110 purposes

Copy of this letter